

# Price elasticity of demand

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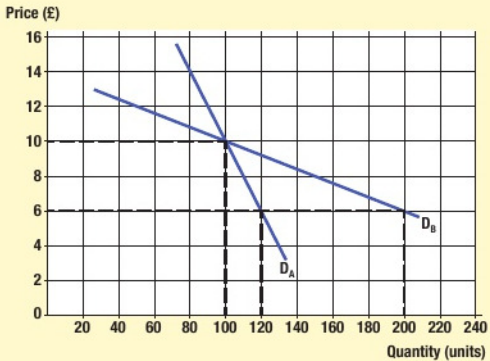
# WHAT IS PRICE ELASTICITY OF DEMAND?

- ▶ Price elasticity: defines how *price changes* will affect the *demand* for a good
- ▶ Demand curve gives the relationship the price of a good and its demand
- ▶ **Price elastic demand:** relationship between the responsiveness of demand and a change in price

# PRICE INELASTIC DEMAND

- ▶ Price *inelastic* demand: change in demand is not as big as the change in price (e.g., petrol)

### The effect of a price change on the demand for products A and B



# PRICE ELASTIC DEMAND

- ▶ Price *elastic* demand: change in demand is greater than the change in price (most goods are price elastic demand)

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- ▶ *see example page 36*

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- ▶ if price elasticity  $> 1$ : demand is **elastic**
- ▶ Note: We consider the *absolute value* of price elasticity!

# THE FACTORS INFLUENCING PRICE ELASTICITY OF DEMAND

Factors influencing price elasticity of demand: mainly *ease* with which customers can switch between products

- ▶ *Time*: Price elasticity of demand tends to fall the longer the time period considered (e.g., petrol may be elastic at short-run since people *have* to use cars, but in the long-run they may switch to other transportation, which will make it inelastic)

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- ▶ *Branding*: Branding reduces the price elasticity of demand for the product

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- ▶ *Product types vs the product of an individual business:* While a demand for a good may be price inelastic (e.g., petrol), the same good may be characterized by high price elasticity when considering the demand at the individual suppliers (e.g., Esso, Shell)

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- ▶ A *profit-maximizing* firm should continue raising price until demand is price elastic
- ▶ As long as the *profit-maximizing* level is not reached, raising prices will raise revenues

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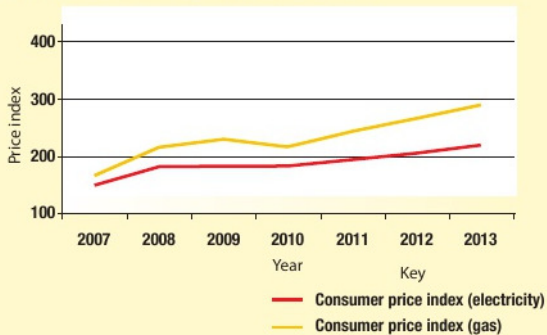
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- ▶ if demand is price elastic: rising prices will affect the demand and this may then not be a good strategy
- ▶ however if demand is price elastic, a fall in prices will also have a (positive) effect on demand (e.g., Lidl, Aldi)

UK gas and electricity prices 2007 to 2013



# PRICE ELASTICITY OF DEMAND AND TOTAL REVENUE

- Change of a particular price on total revenue

Price elasticity	Value of elasticity	Price change	Effect on TR
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- ▶ If businesses know the value of price elasticity for their products, they can predict the effect on total revenue

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- ▶ **Price elastic demand:** a change in price results in a greater change in demand
- ▶ **Price elasticity of demand:** the responsiveness of demand to a change in price
- ▶ **Price inelastic demand:** a change in price results in a proportionately smaller change in demand